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Reasonable maximum rates

Philadelphia

1908

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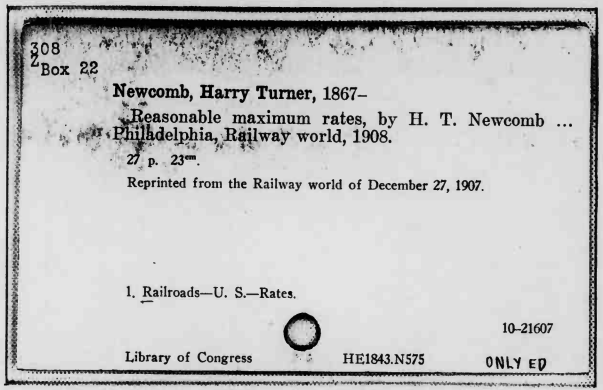

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REASONABLE MAXIMUM RATES

By H. T. NEWCOMB

OF THE BAR OF THE DISTRICT OF COLUMBIA.

Author of "Railway Economics," "The Postal Deficit," "Some Consequences of the Trust Movement," "Recent Phases of the Labor Problem," "The Federal Courts and the Orders of the Interstate Commerce Commission," "The Facts About Railroad Rates," "The New Interstate Commerce Law," "A Conservative Trust Policy," "Public Ownership and the Wage-Earner," "Railway Capitalization," "Rebates," Etc., Etc.

Reprinted from the Railway World of December 27, 1907.

RAILWAY WORLD
Witherspoon Building, Philadelphia
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Reasonable Maximum Rates.

By H. T. Newcomb,

THE EXTENDED AUTHORITY OF THE INTERSTATE COMMERCE COMMISSION.

As everyone knows the authority conferred upon the Interstate Commerce Commission by the Hepburn act[1] differs very materially from that which it exercised under the law formerly in force.[2] The most significant difference, aside from the questionable attempt at delegation of legislative power, is that, instead of restricting the lawful order of the Commission, as formerly, to the mere condemnation of existing rates which it finds unreasonable, leaving the rates to be substituted to the discretion of the carriers affected,[3] the new law authorizes an order prescribing specific rates which shall thereafter, so long as the order remains in force, be "the maximum to be charged." The authority to prescribe reasonable maximum rates attaches when-

1. Approved June 29, 1906, 34 Stat. L., 584; effective August 28, 1906, 34 Stat. L., 584.
2. The Cullom Act (Approved February 4, 1887; effective April 5, 1887) and various supplementary and amendatory statutes.
3. Interstate Commerce Commission *v.* Cincinnati, New Orleans and Texas Pacific, 162 U. S. 184; Same parties, 167 U. S. 479.

ever, the prerequisite conditions of a "complaint" and a "full hearing" in accordance with Section 13 of the law having been satisfied, the Commission has become convinced that the rates challenged are ':unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial." At first glance it would seem that one consequence of this change in the character of the order authorized by the law must be that a complaint now presents to the Commission two questions where only one was presented before. That is to say, that while the inquiry formerly authorized, which was whether the existing rates satisfied the conditions of equality and justice imposed by the law,[4] must still be made it must now be supplemented, when the Commission is of opinion that it ought to be answered in the negative, by the inquiry which asks what are the maximum rates consistent with equality and

4. The question whether these requirements add anything to, or are merely declaratory of the Common Law, has frequently been discussed. It would appear, by the following expression of the Supreme Court to have been authoritatively answered. "Common carriers, whether engaged in interstate commerce or in that wholly within the State, are performing a public service. . . . As a consequence of this, all individuals have equal rights both in respect to service and charges. Of course, such equality of right does not prevent differences in the modes and kinds of service and different charges based thereon. There is no cast-iron line of uniformity which prevents a charge being above or below a particular sum, or requires that the service shall be exactly along the same lines. But that prinicple of equality does forbid any difference in charge which is not based upon difference in service, and even when based upon difference of service, must have some reasonable relation to the amount of difference, and cannot be so great as to produce an unjust discrimination .....
....

"We are clearly of opinion that, . . . the principles of the Common Law are operative upon all interstate commerce transactions, except so far as they are modified by Congressional enactment." Western Union Telegraph Company *v.* Call Publishing Company, 181 U. S. 92, 100, 101; decided on April 15, 1901. See also Interstate Commerce Commission *v.* Baltimore and Ohio, 145 U. S. 263; decided May 16, 1892.

justice. But, although these are plainly separable questions, it is not certain that the condemnation of the existing rates must in every case *precede* the determination of the lawful maximum limits of the rates to be charged for the particular services brought under consideration by the complaint. While it is possible that specific rates might safely be condemned upon testimony insufficient to warrant fixing the lawful maxima for the same services it would seem that, in most instances at least, the question presented might conveniently be conceived as being: What are the maximum rates that may lawfully be charged upon the commodities and between the points covered by the complaint? If, as the result of such an inquiry, the maximum rates should be found to be lower than the existing rates, the conclusion, obviously, must carry with it the condemnation of the latter. With the issue so defined, the complainant must, in effect, propose new maxima, somewhat lower than the existing rates, and endeavor to sustain his proposition by proper testimony and argument.

The chief effect, however, of the express limitation upon the power to fix the rates to be substituted for those condemned, contained in the use of the term "maximum" is in giving statutory expression to the principle that common carriers of interstate commerce are constitutionally protected in the right to receive the highest rates that do not bear unjustly or unequally upon their patrons. Voluntary reductions below the lawful maxima may be made by the carriers but there is no power, legislative or judicial, that can compel the reduction of rates which are

neither unreasonable in themselves nor unjustly discriminatory as compared with other rates.

WHO MAY COMPLAIN.

The complaint necessary to support the rate-fixing authority of the Interstate Commerce Commission may be made by "any person, firm, corporation, or association, or any mercantile, agricultural, or manufacturing society, or any body politic or municipal organization" [5] and "absence of direct damage to the complainant" is not sufficient ground for dismissal [6] but it is at least doubtful whether, since the revision of Section 15, by the Hepburn act, the Commission so completely retains its former power to "institute any inquiry on its own motion in the same manner and to the same effect as though complaint had been made," [7] as to be authorized to fix rates in a proceeding instituted by itself.

THE TESTS OF REASONABLENESS.

Lawful rates must satisfy two standards of reasonableness. That is, rates may be unlawful either (a) because they are in themselves excessive, or (b) because they impose burdens upon the performance of particular services which are so disproportionate to actual differences between those services and others performed by the same carriers as to constitute unjust discrimination.[8] The first of these standards seems peculiarly applicable to cases in which the whole or a considerable section of the

5. Section 13 of the Act.
6. Section 13 of the Act.
7. Section 13 of the Act.
8. Western Union Telegraph Company *v.* Call Publishing Company, 181 U. S. 92, 100, 101; decided on April 15, 1901.

schedule of rates enforced by the defendants are challenged and the second to those in which single rates or those on a few articles or between a few points are the subject of complaint. Between these extremes there are many conceivable cases in which both standards can be fruitfully applied.

RATES EXCESSIVE IN THEMSELVES.

If rates are in themselves excessive it must be because they produce more than a reasonable return upon the fair value of the property employed in the service of the public or exceed the fair value of the services rendered. Thus in sustaining an injunction issued by the Circuit Court of the United States for the District of Nebraska, which perpetually enjoined the making of a schedule of rates for traffic in Nebraska in accordance with a schedule of maximum rates prescribed by an act of the Legislature of that State, the Supreme Court of the United States, in an opinion prepared by Justice Harlan declared that the "fair value" of railway property must be the basis of all inquiries as to the reasonableness of railway charges.[9] A significant extract from this opinion follows:

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property."

9. Smyth *v.* Ames, 169 U. S., 466, 546, 547; decided on March 7, 1898.

Continuing, the Court thus defined the lawful relations between the companies and the public:

"What the company is entitled to ask is a fair return upon that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth."

In another place in the same opinion a sentence occurs which is doubtless equivalent in effect to that last quoted.

"But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public *or the fair value of the services rendered.* . . . "[10]

There are indicated by the foregoing, three separate concepts which obviously require definition. What, it becomes necessary to inquire, are specifically intended by the terms "fair value of the property" and "fair return" which express the rights of the carrier and by the term "fair value of the services," used to express the rights of the purchaser of transportation? May a case arise, as might at first seem possible, in which "fair return upon fair value of property" is in irreconcilable conflict with "fair value of the service?" Observing that it is inconceivable that a case should arise in which a shipper would be entitled as a right to have his goods carried at rates which would preclude a fair return upon the fair value of the property [11] (these terms being correctly understood) it may properly be added that the difficulty of these practical questions obviously suggested the conclusion of the Supreme Court in Covington and Lexington Turnpike Road Company v. Sandford,[12] which is expressed as follows:

10. Smyth *v.* Ames, 169 U. S. 466, 544. The italics are the present writer's.
11. Atlantic Coast Line *v.* North Carolina Corporation Commission, 206 U. S. 1, 25-27.
12. 164 U. S. 578, 597.

"In short each case must depend upon its special facts; and when a court, without assuming itself to prescribe rates, is required to determine whether the rates prescribed by the legislature for a corporation controlling a public highway are, as an entirety, so unjust as to destroy the value of its property for all the purposes for which it was acquired, its duty is to take into consideration the interests both of the public and of the owner of the property, together with all other circumstances that are fairly to be considered in determining whether the legislature has, under the guise of regulating rates, exceeded its constitutional authority, and practically deprived the owner of property without due process of law."

FAIR VALUE OF RAILWAY PROPERTY.

Nothing could be clearer than that the "fair value" which, by the decision in Smyth v. Ames is made "the basis of all calculations as to the reasonableness of rates" is not that familiar sort of value which is a mere consequence of earning power, nor yet the aggregate obtained as the result of a physical inventory. For "original cost of construction," "the amount expended in permanent improvements," "amount and market value of bonds and stock," have nothing whatever to do with either idea of value and "probable earning capacity under particular rates prescribed by statute," and "the sum required to meet operating expenses," have but the most remote and indirect bearing upon the latter. Indeed, it is evident that, realizing the potential injustice of rigorously applying either method of valuation, irrespective of the special circumstances surrounding particular cases, the Court intended to establish a permanent rule which would protect valuations specially adapted to the requirements of each case which should arise. Therefore, it enumerated the principal classes of facts, both historical and contemporaneous, which might affect the problem of justice in valuation and, carefully adding that the list was not in-

tended to be exhaustive, declared that each must "be given such weight as may be just and right in each case."

ORIGINAL COST.

On economic grounds, it is important that investments in transportation facilities, both for original construction and for the improvements from time to time made necessary or desirable by industrial development, should be protected against enforced reductions in rates. For unless such protection exists, either in the form of law or in the wisdom and sense of justice of the people, the owners of capital and those entrusted with its management will be forced to decline to risk it in such undertakings. This might entail no very serious consequences, so far as the general public is concerned, in a community which was industrially stagnant or retrograding but it would be ruinous in one like the United States in which all industry is rapidly expanding.[13] But there can be no such thing as statutory or judicial protection against losses due to improvidence or fraud. If the sums originally expended

13. Some injury of this sort has already occurred in the United States. The fact has been admirably stated by Mr. John F. Wallace, sometime general manager of the Illinois Central Railroad, and later Chief Engineer in charge of the construction of the Panama Canal. Mr. Wallace said in part: "It has been many years since improvements have been provided in this country from an anticipatory standpoint, the construction of the present transcontinental lines being probably the last venture of this character. Railroad construction activity has recently lagged far behind urgent transportation demands in every department. It would be difficult to find a railroad terminal in the United States fully adequate for perfect and economical service; it would be still more difficult to find a single railroad system which is provided with all the facilities for the most economical handling of its business. While the necessity for providing additional facilities is probably realized by every railroad president and board of directors in the United States, many would be unwilling to invest money in anticipation of future increases in business under present conditions. Not even the strongest of the railroad corporations are able to finance the completion of plans already contemplated or under way. The very fact, however, that the situation to-day is acute, lays the foundation for anticipating that it will be speedily corrected through a realization upon the part of the public that our great transportation systems are the arteries and veins through which the life-blood of the Republic surges. When it is realized that hasty and ill-advised national and State legislation has seriously interfered with the proper functions of our vast transportation systems, we can now, as in the past, rely upon public opinion ultimately arriving at proper conclusions and causing a speedy restoration of confidence in the financial stability and earning capacity of our transportation systems. An abundance of capital will again be available and we will then see a new period of engineering and constructive activity which will carry us to greater heights of prosperity."—In *American Industries*, December 1, 1907.

upon construction, in any case, were greater than local conditions and prospects justified; if there was wasteful and extravagant management of the enterprise during the period of construction; if excessive sums were fraudulently paid to favored construction companies; it would be neither just nor practicable to provide for a return upon the excessive sums thus unnecessarily and improperly expended. A more difficult question arises where important items in the original cost of construction were considerably more expensive than they would be under the conditions prevailing at the time covered by the complaint. Here the just rule would appear to be that, except as the reduced cost of construction may have sufficed to bring about actual competition at related points and so as to introduce the factor of unjust discrimination, the fair value should include the necessarily higher cost of the earlier period. This question arose in Milwaukee Electric Railway and Light Company v. Milwaukee, in which it was held that a rate fixed by a city ordinance would not afford fair compensation. The court found that it would require over $5,000,000 to reproduce the property as then existing, and proceeded:[14]

14. 87 Fed. Rep. 577.

"I am further satisfied that this amount is not the true measure of the value of the investment in the enterprise. It leaves out of consideration any allowance for necessary and reasonable investment in purchase of the old lines and equipments, which were indispensable to the contemplated improvement, but of which a large part was of such nature that it did not count in the final inventory. No allowance enters in for the large investment arising out of the then comparatively new state of the art of electric railways for a large system, having reference to electrical equipment, weight of rails, character of cars, and the like, of which striking instance appears in the fact that the electric motor which then cost about $2,500 can now be obtained for $800; so that work of this class was in the experimental stage in many respects, and the expenditures by the pioneer in the undertaking may not fairly be gauged by the present cost of production."[15]

AMOUNT AND MARKET VALUE OF SECURITIES.

It is useless to contend, at the present day, that there is any certain or fixed relation between the aggregate par value of stocks and bonds and either original cost or present actual value of the properties.[16] Unquestionably

15. The same view was taken in Metropolitan Trust Company *v.* Houston & Texas Central (90 Fed. Rep. 683) but it was held otherwise in Steenerson *v.* Great Northern (69 Minn. 353).

16. "The capitalization representing American railways consists of securities of many different grades, each grade making its claim for annual returns to its owners with separate force and having its own degree of power or lack of power to enforce its demands. The highest grade of security consists of mortgage bonds which carry the right to a definite income with the property itself pledged against default. Other funded debt includes bonds based upon income which involve no lien upon the property and equipment trust obligations secured by liens upon rolling stock. The volume of each of the different classes of capital issues and its proportion to the mileage and to the aggregate capitalization are as follows:

Class.	Total.	Per mile of line.	Per cent of total capitalization.
Mortgage bonds	$5,456,349,002	$25,142	48.86
Income bonds	253,707,699	1,169	2.27
Equipment trust obligations .	186,302,906	859	1.67
Miscellaneous obligations ..	786,241,442	3,623	7.04
Shares of stock	4,484,504,943	20,664	40.16
Total	$11,167,105,992	$51,457	100.00

Actually, there is something quite ridiculous in the effort to combine these incongruous items in a single aggregate. It is possible to add three elephants, eight cows, seven mice and a guinea pig and to say that the total is nineteen animals, but the aggregate is not very enlightening and scarcely repays the effort. The items which make up the aggregate railway capitalization are not less incongruous. There are included in the aggregate usually given no less than $582,492,783 in par value of bonds which regularly pay six per cent or more per annum and with them, also at their par value, $2,435,470,337 of stock on which nothing has been paid for a decade. Ten shares of the Union Pacific Railway paying their owners $100 yearly and worth in the market at present prices about $1,350, ten shares of the Chicago Great Western Railway common which have never paid their owner anything and can be bought in the market for less than $125, ten shares of the Delaware, Lackawanna and Western which have paid $710,000 to their owners within five years and can be sold any day for about $4,500, ten shares of Pere Marquette Railway which represents a property now insolvent and in the hands of a receiver, a $1,000 mortgage bond of the Chicago and North-Western Railway bearing seven per cent interest per annum, and a $1,000 Lake Shore collateral bond of the New York Central bearing 3½ per cent interest, all have the same par value. Add these par values together and you get a total par value of $6,000. What is such figure worth for any purpose worthy of an intelligent man? Yet that is the way that aggregate capitalization is ascertained."—H. T. Newcomb, in RAILWAY WORLD for June 7, 1907, article entitled "Railway Capitalization."

there are many railways whose real value exceeds the par value of all their outstanding securities while there are others, much less numerous or extensive than formerly, with regard to which the opposite relation probably exists. So while capitalization may throw some light upon the problem of "fair value," it will do so only so far as a relation between par values and money expended, including proper discounts upon issues that could not be sold at par, can be established. The rule, laid down in Smyth v. Ames,[17] is as follows:

"If a railroad corporation has bonded its property for an amount that exceeds its fair value, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds, and obligations,

17. 169 U. S. 466, 544, 545.

is not alone to be considered when determining the rates that may be reasonably charged."

COST OF REPRODUCTION.

Cost of reproduction, both with and without suitable allowance for depreciation, has at different times and under different circumstances been suggested as the determining factor in fixing that value which must be a principal criterion of reasonableness in charges. While apparent sanction for these suggestions can be found in some of the earlier judicial opinions [18] it can no longer be held that this, or any other criterion, can be indiscriminately applied to all cases or, in any case, to the exclusion of other and usually more significant facts. Testimony as to current cost of reproduction would certainly be regarded as relevant to almost any inquiry as to the value on which a fair return must be allowed but it could rarely, if ever, be properly taken as conclusive on that point.

PROBABLE EARNING CAPACITY UNDER LAW-MADE RATES.

In the absence of contractual charter provisions expressly limiting the regulative powers of the State creating the carrying corporation, its very existence and right to do business are conditioned by the right of the Federal and State governments to which it is subject, each in its proper sphere and through the proper legislative and judicial agencies, to require and to enforce reasonable charges. Therefore it is highly proper and, indeed, necessary that the reservation of this power and its proper or probable exercise within the reasonable limits constitu-

18. Steenerson *v.* Great Northern Railway, 69 Minn. 353 Per Contra Metropolitan Trust Company *v.* Houston & Texas Central, 90 Fed. Rep. 683.

tionally established should be considered. This is the plain meaning of the expression in Smyth v. Ames and it probably goes no further than to insist that there must not be any allowance for any imaginary or speculative value that might attach were the power to charge for services rendered without effective governmental regulation. Whether, in any event, such a value could exist under any except the most abnormal conditions might be made the subject of interesting theoretical inquiry but it could now have only academic value.

OPERATING EXPENSES AND TAXATION.

The cost of operation, varying geographically and from time to time, as wages, the efficiency of labor and the cost of fuel and other materials rise or fall, must necessarily affect the balance of earnings available for payments to investors and hence act with controlling force upon real value. The same is true of the rate and amount of the taxes exacted by the various taxing bodies having jurisdiction over the particular line, although this item was not specifically enumerated in the opinion in Smyth v. Ames. Generally, however, it may be said that these elements are more naturally considered as determining the reasonable return which rates must provide than as bearing upon the basic value. The fund annually earned, to be reasonable to the carrier, must be large enough to pay the standard wages, liberally adjusted, for services of standard quality; to maintain the property in the condition demanded by the growing commerce of the territory served; to supply the full sums demanded to meet taxation

and to leave the adequate balance necessary for a fair return upon a fair valuation.[19]

FAIR RETURN.

The whole schedule of rates of a railway must be framed with the purpose of producing, from a vast multitude of widely varying services and in an equally large number of relatively small payments, an aggregate equal to the total expenditure for operation, wages, materials, taxes, maintenance, repairs, replacements and depreciation, plus interest on indebtedness and a reasonable return to shareholders having a substantial investment interest in the property.[20] Assuming, therefore, that it will be conceded, in any case, that there can be no interference with rates on the part of public authority which does not allow fully for all expenses of maintenance and operation the inquiry may proceed to the more difficult question, as to what relation the balance of earnings, after expenses are met, must bear to the fair value of the property as ascertained according to the rules already discussed. It will invariably be found that the ownership of railway property is

19. "Cost of service implies skilled labor, the best appliances, keeping the roadbed and the cars and machinery and other appliances in perfect order and repair. The obligation of the carrier to the passenger and the shipper requires all these. They are not matters which the carrier can dispense with, or matters whose cost can by them be fixed. They may not employ poor engineers, whose wages would be low, but must employ competent engineers, and pay the price needed to obtain them. The same obtains as to engines, machinery, roadbed, etc., and it may be doubted whether even the legislature, with all its power, is competent to relieve railroad companies, whose means of transportation are attended with so much danger from the full performance of this obligation to the public." Chicago & Northwestern *v.* Dey, 35 Fed. Rep. 866. See also Chicago, Milwaukee & St. Paul *v.* Tompkins, 176 U. S. 167.

20. J. Shirley Eaton, Railroad Operations; How to Know Them, pp. 263 et seq.

partitioned among the several holders of beneficial interests therein in many different ways. There are not only mortgage bonds, but frequently several successive mortgages given to secure bonds bearing different rates of interest and maturing at different times. There are also debenture and income bonds, collateral trust bonds, equipment trust bonds and many grades of unfunded obligations. Following these are preferred and common or ordinary shares with varying conditions. All of these, so far as based upon "fair value of property being used for the convenience of the public," are entitled, in their several proportions, to a fair return. Like the question of "fair value" that of "fair" or "reasonable" return must not be determined arbitrarily in any case, or by the strict application of rigid mathematical rules, but rather by a searching inquiry into all of the conditions peculiar to the case in hand and in a broad and enlightened spirit of full justice to all concerned. As said by Chief Justice Waite, speaking for the majority of the Supreme Court in the Railroad Commission cases:[21]

> "Under pretense of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to taking private property for public use, without just compensation, or without due process of law."

BONDS AND SHARES.

Assuming that the "fair values" respectively represented by bonds and shares have been ascertained, the respective rights of the holders of different grades of securities as to what constitutes a fair return can be considered.

21. 116 U. S. 307; decided on January 4, 1886. See also Reagan *v.* Farmers' Loan & Trust Company, 154 U. S. 362; decided on May 26, 1894.

As to bonds, the conclusion expressed by Mr. Justice Brewer, while sitting as a Federal Circuit Judge, in Chicago and North Western Railway v. Dey,[22] represents the still prevailing view. This conclusion was expressed as follows:

> "Whatever individuals may do by private contract to modify existing rates of interest, the legislature has no compulsory power in the matter. While, by reducing the rates, the value of the stockholders' property may be reduced, in that less dividends are possible,—and that power of the legislature over property is conceded,—yet if the rates are so reduced that no dividends are possible, and especially if they are such that the interest on the mortgage debt is not earned, then the enforcement of the rates means either confiscation, or compelling, in the language of the Supreme Court, the corporation to carry persons or property without reward."

In spite of the fact that the duty of the courts to protect rates of interest which are higher than those prevailing at the time the question is raised has been doubted, it seems certain that the owners of bonds which were previously issued, for value, at a rate which was reasonable and fair at the time the contract was made, are entitled, as against governmental interference with charges, to judicial protection in the receipt of the full interest provided for in the bonds during the whole period for which they are issued. While there may be economic conditions under which it is impracticable for particular railway companies to enforce rate schedules which will produce sufficient revenue to meet the lawful demands of bond holders, and this is a risk accepted by all investors in this kind of securities, it is not believed that such conditions can properly be created or accentuated by legislation.

At this stage of the present inquiry, the question as to what may be considered a fair return to the owners of

22. 35 Fed. Rep 866.

corporate shares in railway enterprises, should not be complicated by any misunderstanding growing out of current allegations as to the amount of "water" represented by securities of this class. It is now assumed that the "fair value" represented by these securities has been ascertained, and the question is no longer what real interest they represent, but rather what is a fair return upon the real interest previously found to exist. In this respect, the doctrine announced in Chicago and North Western Railway v. Dey, previously cited, no longer prevails. The rule prescribed in that case, that the legislature can reduce dividends to a minimum, provided some dividends are permitted, has been supplanted by that which requires and sanctions a reasonable or fair return. Thus in New Memphis Gas Light Company v. New Memphis [23] the court said:

> "The company has a right to such gross revenue from the sale of gas as will enable it to pay all legitimate operating expenses, pay interest on valid fixed charges, so far as bonds or securities represent an expenditure actually made in good faith, and also to pay a reasonable dividend on stock, so far as this represents an actual investment in the enterprise."

In determining what is a reasonable rate of return, the courts will undoubtedly consider the risk accepted by owners of shares and will, therefore, accord a higher rate than would be authorized under similar conditions upon mortgage bonds. The rate will also vary in different localities and will be influenced by the current rate of interest on investments of similar security. It would seem also that, where shareholders have gone for many years without any return upon their investments, or with too meagre returns, the rate afterward permitted should be

23. 72 Fed. Rep. 952.

sufficient, when spread over the whole investment period, to produce a fair average return for each year.

PROVISION FOR THE FUTURE.

It has been suggested that a fair return should provide a sinking fund for the payment of bonded obligations upon maturity and it has been so held in the case of a municipally owned waterworks[24] and also in the case of a private water company.[25] Whether such an effort would receive judicial protection in the case of a railway carrier is doubtless a question that would have to be determined in the light of the particular circumstances attending the case in which the question arose. There are conditions under which such a provison would seem reasonable and just and others are conceivable in which public policy would suggest dependence on ability to refund the securities at maturity. In the case of shares of stock, however, it would seem that in times of business activity rates high enough to provide a surplus which would tend to insure the continuance of reasonable dividends ought to be permitted. This is the conclusion of the Interstate Commerce Commission, expressed as follows:[26]

"But it may be urged that after paying its fixed charges, taxes and dividends out of its net income for the year 1902, it had left but a comparatively small amount. That year was one of prosperity, and it can hardly be expected that conditions will continue without interruption as favorable. Ought not a railway to be allowed to accumulate, in some form, a surplus during fat years which may tide over subsequent lean years? To this we would unhesitatingly answer in the affirmative. In times like the present a railroad company should be allowed to earn something more than a merely fair return upon the investment. . . . ."

24. Preston *v.* Detroit Water Commissioners, 117 Mich. 589.
25. Brymer *v.* Butler Water Company, 179 Pa. 231.
26. 9 I. C. C. Rep. 382. See, also, Illinois Central *v.* Interstate Commerce Commission, 206 U. S. 441, 461-463, in which provision for the future in the shape of permanent improvements is discussed.

PARTICULAR RATES.

So far, this discussion has related to whole schedules or to considerable and plainly separable portions of the schedules. In dealing thus broadly with the subject, it is apparently possible to answer all the questions which may arise from the point of view of a "fair return" upon a "fair value." It was noted at the outset, however, that a third concept, that of "the fair value of the services rendered," has received the sanction of the Supreme Court. While the interest of the railway carrier is not, as is frequently urged, confined to the total return produced by its schedule but, on the contrary, it is deeply concerned as to the effect of particular rates upon the development of traffic and upon the growth of the regions contiguous and tributary to its lines, it is true that there are questions, as to the relative adjustment of the different elements in a schedule, which can only be determined by considerations not indicated by the terms "fair value" or "fair return." Thus, when a single rate or rates on a few commodities or between a few points are challenged, it becomes necessary to inquire whether they exceed the "fair value of the services rendered" and hence amount to an unjust exaction from the purchasers of transportation or whether their enforced reduction would deprive the carrier of just compensation for the services which it performs.

Questions of this sort will arise concerning the adjustment of rates as between competing sources of supply or competing markets, between main and branch lines, between shipments in different quantities or different commodities or classes of commodities. They are frequently of especial economic importance when the question is as to

the proper relative adjustment of rates upon raw materials and their finished products. Although inquiries of this character have taken up a large share of the time of the Interstate Commerce Commission since it was organized in 1887, there have been relatively few cases in which the courts have attempted to lay down principles or rules which can be regarded as authoritative. It is exceedingly difficult, even in the decisions of the Commission, to trace principles of other than the most general character, and as this paper is already too long to permit extended discussion of the subject, it is sufficient to indicate some of the general considerations pertinent to such inquiries and to suggest that each particular case must be taken up in the light of its own peculiar circumstances. Inquiry of the broadest character may be necessary in any case and it is impossible to say of almost any class of facts pertaining to industry and transportation that they may not at some time become of controlling force in determining the lawful charge for a particular service. Length of haul, character of territory traversed, density of traffic, the direction in which the bulk of the traffic moves, quantity of similar shipments, manner of preparation for shipment, character of equipment required, special facilities necessary, risk of loss or damage through accident, effect upon the development of other business, value of the articles carried, special costs of service, demands upon terminals, comparisons with other rates, physical characteristics of route and many other considerations may, any or all of them, be relevant to such an inquiry and in particular cases are entitled to varying weight.

The rights of the railway carriers in this respect were defined by Mr. Justice Jackson while sitting in the Circuit

Court in language[27] subsequently quoted with approval by Mr. Justice Brewer in the opinion in Interstate Commerce Commission v. Cincinnati, New Orleans and Texas Pacific.[28] The quotation is as follows:

> "Subject to the two leading prohibitions that their charges shall not be unjust and unreasonable, and that they shall not unjustly discriminate, so as to give undue preference or advantage, or subject to undue preference or disadvantage persons or traffic similarly circumstanced, the Act to regulate commerce leaves common carriers as they were at Common Law, free to make special contracts looking to the increase of their business, to classify their traffic, to adjust and apportion their rates so as to meet the necessities of commerce, and generally to manage their important interests upon the same principles which are recognized as sound, and adopted in other trades and pursuits."

In the same opinion Judge Jackson also said:[29]

> "Subject to these conditions and limitations, the Act does not, and was not intended to, restrict the Common Law right and power of common carriers to make special contracts, or adjust their rates with reference to existing wants and circumstances, so as to promote their own interests, while affording all proper and reasonable facilities and conveniences to the public. Subject to the above conditions, the Act intended to leave the adjustment of rates as absolutely and completely in the discretion of the carrier as it existed at Common Law, which never questioned or denied to common carriers the right to give or make lower rates, based on increased quantity or amount of service."

The Interstate Commerce Commission has seemed to hold, from the beginning, that it must be extremely difficult, if not impossible to establish definite principles applicable to all classes of cases. It is apparently for this reason that it was inclined to contend, at least up to the time of the enactment of the Hepburn law, that the discretion necessarily to be exercised in determining these questions is rather of a legislative than a judicial or an ex-

27. 43 Fed. Rep. 37, 50, 51.
28. 167 U. S. 479, 493.
29. 43 Fed. Rep. 37, 44.

ecutive [30] character. Thus, as early as 1891, in Delaware State Grange v. New York, Philadelphia and Norfolk Railway,[31] the Interstate Commerce Commission said:

"The mandate of the statute is that all rates must be reasonable and just, but how the reasonableness and justice of a rate are to be determined is not prescribed by the statute, nor has any satisfactory test been evolved by transportation experts. . . . A rate that might be regarded as reasonable and just by a producer and shipper, might, from a carrier's standpoint, be deemed extremely unreasonable and unjust, and so, conversely, a rate that a carrier might claim to be reasonable in itself, and that it might support with strong reasons based upon the cost of service, the quantity of the business and the characteristics of its line of road, might exhaust the greater part of the proceeds of the producer's commodity, and be destructive to his interests. It is only stating a truism, therefore, to say there is no recognized test of a rate mutually reasonable for a carrier and for a producer of the traffic. The reasonableness of a rate must consequently be ascertained in every instance in which the question arises, by its relations both to the carrier and to the shipper, and by comparison with rates normally charged for like or similar service."

Similarly, in the year 1902, Mr. Commissioner Prouty, speaking for the Commission, said: [32]

"It is plain that until there be fixed, either by legislative enactment or by judicial interpretation, some definite basis for the valuation of railroad property, and some limit up to which that property shall be allowed to earn upon that valuation, that there can be no exact determination of these questions. In the absence of such a standard, the tribunal, whether court or commission, which is called upon to consider the matter, can only upon the whole exercise its best judgment."

Even as late as May, 1906, one month before the passage of the Hepburn Act, writing for the *American Review of Reviews*, Mr. Commissioner Prouty expressly declared that rate fixing is, in its nature, a legislative function. An extract from this article follows:

"Now the fixing of a railway rate is in its nature legislative rather than judicial. There is no standard by which it can be determined. It might be thought that the price charged for a transportation service ought to be governed by the cost of rendering that service; but it is agreed on all hands that, assuming the possibility of ascertaining the cost, still our interstate rates could not be made on that basis. A comparison with other rates is of but little value, since conditions are seldom the same in two cases. The element of competition plays an important part, and one of the most difficult questions to decide is how far a carrier may properly discriminate in view of competitive conditions. Assuming that the amount of money which a railroad ought to earn is fixed, from what source shall it derive that amount? How much shall come from the passenger business? How much from freight? What rate shall be applied to a particular species of freight as compared with other commodities? In determining the justice or reasonableness of a particular rate all these factors, and many others, may present themselves for consideration. They are proportionately taken into account by the traffic official who fixes the rate in the first instance, and they must be considered by the administrative body which revises that rate. It is finally a question of judgment what, taking everything into account, ought fairly to be done."

Without assuming, as perhaps might seem justifiable from the foregoing, that it will forever be impracticable to evolve definite principles for guidance in applying the lawful standards to questions of rate regulation, it is sufficiently plain that in the present state of interpretation at least, the principles are so inadequately defined that it is necessary, in every such controversy, to regard the issue as of the broadest character and, therefore, to submit to the regulating tribunal all those facts and economic considerations which seem at all relevant. Otherwise, either the Commission or the courts are liable to fail to find in the record facts which they will consider essential to the particular case and to regard themselves as forced to conclusions which on fuller presentation might have been avoided.

30. The term "administrative" has frequently been used as indicating the sort of discretion involved in rate-fixing by a Federal, but non-judicial, tribunal. It is exceedingly difficult, however, to understand how anyone at all comprehending the principles of the distribution of Federal powers under the Constitution can find any place in the executive branch of the Government for a tribunal exercising powers which may properly be defined as administrative, in the accepted political sense.

31. 3 Int. Com. Rep. 554.

32. Re Advance in Freight Rates, 9 I. C. C. Rep. 391.

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TITLE